(6)

No. 83-1961

In the Supreme Court of the United States

OCTOBER TERM, 1984

LANDRETH TIMBER COMPANY, PETITIONER

v.

IVAN K. LANDRETH, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE*
and
BRIEF FOR ADVANCE ROSS CORPORATION AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

STEPHEN M. SHAPIRO*
DAVID M. MICHAELSON
GEORGE V. BOBRINSKOY, JR.
JAMES J. JUNEWICZ
Mayer, Brown & Platt
231 S. LaSalle Street
Chicago, Illinois 60604
312-782-0600

BARBARA A. REEVES
DONALD I. BERGER
Morrison & Foerster
333 S. Grand Avenue
Los Angeles, California 90071
213-626-3800

* *Counsel of Record*

PANDICK MIDWEST INC., • 454-7600

6

In the Supreme Court of the United States

OCTOBER TERM, 1984

No. 83-1961

LANDRETH TIMBER COMPANY, PETITIONER

v.

IVAN K. LANDRETH, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE*
and
BRIEF FOR ADVANCE ROSS CORPORATION AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

Advance Ross Corporation, a Delaware corporation based in Chicago, Illinois, respectfully moves pursuant to Rule 36.3 of the Rules of this Court for leave to file a brief *amicus curiae* in support of respondents. The consent of counsel for petitioner and respondents has been requested but denied. Advance Ross Corporation's interest in this case, and its special perspective on the issues presented, are briefly described in this motion.

In December 1982, Advance Ross Corporation ("Advance Ross") sold a wholly-owned subsidiary, AMI Industries ("AMI"), to Algeran, Inc. ("Algeran"). That sale came in the aftermath of a six-month period of negotiation, repeated on-site inspections of AMI's premises, a review of AMI's receivables by accountants, and a disclosure of non-public records and data

requested by Algeran. The parties embodied their purchase agreement in a 64-page contract, which was negotiated by experienced corporate lawyers and which contained extensive warranties and covenants concerning the rights and obligations of the purchaser and seller. Among those covenants and warranties were specific promises concerning operations, assets, liabilities, and the accuracy of financial information. See Add., *infra*, A-6 to A-24. The parties expressly agreed that any disputes concerning the sale transaction or breaches of any warranty or covenant were to be decided under California law (*id.* at A-23), and that all such disputes were to be resolved by arbitration rather than by judicial proceedings. *Id.* at A-23 to A-24, A-19 to A-20.

The purchase agreement between Advance Ross and Algeran transferred control over AMI by conveying 97% of its stock. The remainder of the shares were lost shares; the transferred shares therefore represented all existing and identifiable stock. Algeran paid Advance Ross the purchase price part in cash and part in promissory notes secured by a pledge of AMI's stock. Immediately after the sale transaction, Algeran assumed control of AMI, installed a new board of directors, and began to manage the company as its own wholly-owned subsidiary (Add., *infra*, A-1 to A-3, A-20).

Within two business days after the closing of the sale, Algeran began to complain about alleged "nondisclosures" in the sale negotiations and demanded a reduction in the purchase price. Despite its unequivocal promise to arbitrate, Algeran claimed a right to sue in federal court under the securities laws by reason of this Court's decision in *Wilko* v. *Swan*, 346 U.S. 427 (1953), which, it asserted, overrode the unambiguous arbitration covenant.

Algeran then filed a complaint in the United States District Court for the Central District of California, alleging various purported nondisclosures in violation of the securities laws. A lengthy period of discovery ensued. During that period of discovery, Advance Ross uncovered proof that Algeran's principals previously had purchased several other corporations and had used litigation to coerce decreases in the purchase price. Moreover, they reduced at least two of the corporations which they purchased to worthless shells after acquisition. Appendix in Support of Motion for Summary Judgment at 1-153.

Throughout the lengthy pretrial proceedings that resulted from Algeran's initiation of securities litigation and its refusal to arbitrate, Algeran relied on the pendency of securities litigation to delay foreclosure on the AMI stock which Advance Ross held as collateral. Advance Ross therefore was forced to stand by helplessly while its collateral dwindled in value due to Algeran's extraction of funds from AMI. Ultimately, both Algeran and AMI filed bankruptcy petitions.

Algeran's delaying tactics could have continued indefinitely given the amount of time that it takes to resolve a securities case in federal court. However, approximately a year and a half after Algeran filed its securities complaint, the Ninth Circuit decided the case of *Landreth Timber Co.* v. *Landreth*, 731 F.2d 1348 (9th Cir. 1984), which affirmed the sale of business doctrine and which held that privately negotiated sales of substantially all of the stock of a corporation are beyond the scope of the federal securities laws.

Applying the Ninth Circuit's decision in *Landreth*, the district court dismissed Algeran's securities law claims. After dismissal of those securities law claims, *Wilko* v. *Swan* no longer stood as an obstacle to arbitration and the district court enforced the arbitration agreement. The court observed that "arbitration may well be the speediest method of resolving the claims in this case." Add., *infra*, at A-3. Moreover, having dismissed the securities law claims, the district court also permitted Advance Ross to exercise its contractual rights as a secured creditor—rights which had been hindered for over a year and a half by Algeran's initiation of securities litigation.

In view of these recent events, it is apparent that this Court's decision concerning the validity of the sale of business

doctrine may have a substantial impact on the final resolution of the controversy between Algeran and Advance Ross. Accordingly, Advance Ross has a direct interest in the outcome of this litigation.

In the Algeran litigation, as in the case now before this Court, federal jurisdiction was premised on the assumption that a privately negotiated sale of all of the stock of a corporation is a "security" transaction subject to the federal securities laws. As we demonstrate in this *amicus* brief, that assumption is totally unfounded. This brief also demonstrates the far-reaching importance of the sale of business doctrine and the danger of "vexatious litigation" (*Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 739 (1975)) which would follow from a rejection of that doctrine. In particular, this brief describes the injustice and waste that result from condoning evasion of negotiated sale agreements by resort to securities litigation. Superimposing securities law remedies would effectively strip away contractual remedies negotiated by sophisticated parties of equal bargaining power, and would nullify express covenants to arbitrate which are essential to many sale of business transactions.

In view of Advance Ross Corporation's recent experience with sale of business litigation, its views on the legal and policy issues raised by this case should materially assist the Court and provide a useful supplement to the presentation of respondents.

Respectfully submitted,

STEPHEN M. SHAPIRO

Mayer, Brown & Platt
231 South LaSalle Street
Chicago, Illinois 60604
312-782-0600

Counsel of Record for
Advance Ross Corporation

QUESTION PRESENTED

Whether a privately negotiated sale of business, which is evidenced by a transfer of all of the stock of a closely-held corporation and which is accompanied by the purchaser's assumption of control over all of the assets and operations of the corporation, is in economic reality a sale of "securities" within the meaning of the federal securities laws.

TABLE OF CONTENTS

Table of Authorities

BRIEF FOR ADVANCE ROSS CORPORATION AS *AMICUS CURIAE*

INTEREST OF THE *AMICUS CURIAE*

As explained in the foregoing motion for leave to file the instant brief *amicus curiae,* Advance Ross Corporation has a direct interest in the present case because it is now a defendant in a suit which raises the validity of the sale of business doctrine (see Add., *infra,* at A-1 to A-3).

STATEMENT

1. The sale of business involved in this case resulted from three months of private negotiation between respondents, the owners of a closely-held family corporation, and a representative of petitioner, a senior partner in a major law firm who was experienced in corporate acquisitions. J. App. 80-81, 264. Each side to the negotiations was represented by counsel. *Id.* at 171, 286. During the negotiations, the purchaser's agents conducted an extensive investigation of the acquired business—an inoperable sawmill then under reconstruction. In addition to personally visiting the premises, they retained an engineering firm which analyzed the underlying assets, a certified public accountant who investigated the financial condition of the business, and a bank officer who examined the operation of the business before providing financing. *Id.* at 84-86, 105-171, 217, 225-247. The purchaser's right to conduct a "pre-acquisition audit of the business and records of the company" (*id.* at 217) encompassed every feature of the financial and business operations of the acquired entity, including confidential financial information, relations with customers, equipment and inventories, past earnings records and income tax returns, corporate minute books, cash flow projections, and internal controls. *Id.* at 84-86, 106-111, 115, 127, 139, 154, 225.

The negotiated purchase agreement, providing for payment in cash and notes over an extended period of time in exchange for all of the stock of the acquired company, exceeded 60 pages in length. J. App. 206-274. The agreement contained comprehensive inventories and appraisals of the "physical assets" of the acquired company (*id.* at 210, 235-250), and a host of specially negotiated "warranties" by the sellers relating to assets, liabilities, and operations (*id.* at 208-213, 217-218, 227-233). In addition, the purchase agreement contained specific provisions designed to remedy any inaccuracy in the assurances and warranties made in the inducement of the transaction. The agreement provided that all "representations and warranties made by Sellers to Buyer * * * in this Agreement or any document furnished or to be furnished by any of them hereunder shall be true and correct in all material respects" (*id.* at 215). It also prescribed a remedial mechanism to deal with any breach of warranty or promise, including a formula for computing damages to be paid (*id.* at 218-219). Although the purchase agreement made repeated reference to the "laws of the state of * * * incorporation" and the "Uniform Commercial Code" (*id.* at 215-216), it nowhere referred to the provisions of the federal securities laws. The record contains no indication that the parties to the transaction expected the federal securities laws to govern their respective rights and obligations.

2. Following the closing of the sale transaction, the acquiring corporation assumed complete control over the business and operated it subject to its own managerial policies. The sellers retained no interest in the business and all of the former directors and officers resigned their positions. J. App. 183-186, 284-285. Moreover, prior to the closing, the purchaser selected its own "general manager," who supervised the day-to-day

operations of the company. *Id.* at 187-201. It is undisputed that the sellers retained no control over the management of the business and had no ability to direct its operations after the closing.

Unfortunately, the purchaser did not succeed in operating the business profitably, and, some months after the acquisition, it accused the sellers of providing inaccurate information during the sale negotiations. J. App. 90-94. The purchaser subsequently filed suit in the Superior Court for the State of Washington, *Landreth Timber Company* v. *Ivan K. Landreth*, Civ. No. 80-2-11740-8, a suit which alleged, *inter alia*, breach of contract and warranty and common law deceit. The purchaser also filed suit in federal district court, raising the same allegations presented in state court and asserting jurisdiction under the federal securities laws. J. App. 37-50.

3. The district court granted summary judgment and dismissed the securities law complaint, concluding that Congress never intended the federal securities laws to apply to privately negotiated sales of an entire business. Pet. App. 12a-20a. Looking to the "economic realities," the district court found that the transfer of stock certificates was merely incidental to the consummation of a "commercial" transaction (*id.* at 18a), and that the purchaser, who fully intended to own and operate the business itself, did not expect to earn profits "from the managerial or entrepreneurial efforts of others" (*id.* at 19a-20a.).

The court of appeals unanimously affirmed. Pet. App. 1a-10a. Speaking for the court, Chief Judge Browning explained that the "underlying transaction involved the sale of an entire business * * *. Following the transaction, [the purchaser] had full control of the corporation, including the day-to-day operations of the mill and its employees. In 'economic reality,' the underlying transaction was a sale of a lumber business and * * * not an investment in a 'security.' " *Id.* at 9a.

INTRODUCTION AND SUMMARY OF ARGUMENT

The court of appeals correctly concluded that the "economic reality" of the transaction in this case was a sale of business and not an investment in securities. To treat the transaction as a purchase of "securities" would exalt form over substance. The purchaser in this case no more purchased "securities" than the purchaser of a home or automobile purchases a "deed of title" with his funds. The stock certificates transferred in this case, like a deed of title, merely formalized the transfer of ownership of the entire business enterprise—lock, stock and barrel. Because the purchaser here did not invest in certificates symbolizing a pro rata interest in an enterprise managed by others, and was in a position to negotiate on a one-on-one basis for information and contractual protection specially adapted to its needs, it did not engage in a "security" transaction within the meaning of the federal securities laws.

The language used by Congress is, of course, the starting point in any case of statutory interpretation. The definition of "security" contained in both the Securities Act of 1933, 15 U.S.C. 77b, and the Securities Exchange Act of 1934, 15 U.S.C. 78c(a), provides that the term "security" shall include "stock" — "unless the context otherwise requires." As this Court held in *Marine Bank* v. *Weaver*, 455 U.S. 551, 556 (1982), that express caveat is an important restriction on the broad language used in the definitional provisions: "The broad statutory definition is preceded * * * by the statement that the terms mentioned are not to be considered securities 'if the context otherwise requires * * * .' [W]e are satisfied that Congress, in enacting the securities laws, did not intend to provide a broad federal remedy for all fraud." The Court in *Weaver* then proceeded to carefully analyze the economic reality surrounding two transactions, both of which fit within the definitions prescribed by Congress, but both of which, upon examination, were found to be commercial in nature and beyond the scope of Congressional intent.

That Congress did not mean to subsume privately negotiated sales of entire businesses within the statutory definition of a "security" sale is manifest from a consideration of the meaning of the terms "stock" and "security" when Congress enacted the federal securities laws. In this respect, it is appropriate to examine contemporary dictionary definitions. See *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 199 nn. 20-21 (1976) (relying on *Webster's International Dictionary* (2d ed. (1934)). *Webster's International Dictionary* (2d ed. 1934) establishes that the meaning of the term "stock" was "[s]hares or holdings, *collectively*, in a corporate business enterprise * * *," while the term "security" referred to "[a]n evidence of debt or of property, as a bond [or] stock certificate, * * * a document giving the holder the right to demand and receive *property not in his possession.*" *Id.* at pp. 2480, 2263 (emphasis supplied). Thus, fifty years ago, the words "stock" and "security" denoted precisely what they denote today: collective holdings which symbolize the financial interest of investors in the assets of a business enterprise not in their possession.

It is contrary to the "ordinary concept of a security" transaction (*United Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837, 851 (1975)) to treat the sale of an entire business—in which stock is transferred as a mere incident of a conveyance of ownership and control—as a sale of "securities." In such a transaction, there is no "collective" investment in a venture managed by others, but rather the transfer of an entire business, including its physical assets, to be operated by the purchaser alone. Certainly, the average person, giving the words used by Congress their ordinary meaning, would not perceive this to be an investment in securities as opposed to the outright purchase of a business enterprise.

This view of the economic realities surrounding a sale of business is particularly compelling in the present case, where the purpose of the purchaser was not to acquire investment securities but rather to obtain control of the physical assets of

the enterprise. As the purchaser's representative explained (J. App. 83): "I told defendant Landreth that we wanted to purchase the operating assets and inventory of the sawmill from Landreth Timber Company. I informed Mr. Landreth that I was reluctant to purchase the corporate shares * * *." The fact that the transaction ultimately took the form of a stock transfer, rather than an asset transfer, rested solely on tax considerations that are irrelevant to the expectations of the parties regarding the law that would govern a dispute such as this. *Id.* at 83, 107.

The courts of appeals in four circuits have concluded that the sale of a corporation, accompanied by a transfer of all of its stock in a privately negotiated transaction, is a sale of business and not a securities sale.[1] That view is supported by the great weight of academic scholarship.[2] As we demonstrate in this brief, that view also is compelled by this Court's past decisions, by the legislative history of the federal securities laws, by principles of federalism, and by the compelling need to prevent the federal securities laws from being used as instruments for the infliction of fraud and the destruction of contractual rights.

---

[1] See *Landreth Timber Co.* v. *Landreth*, 731 F.2d 1348, 1350-1353 (9th Cir. 1984); *Christy* v. *Cambron*, 710 F.2d 669, 672 (10th Cir. 1983); *Sutter* v. *Groen*, 687 F.2d 197, 199-204 (7th Cir. 1982); *Kaye* v. *Pawnee Constr. Co.*, 680 F.2d 1360, 1366 n. 2 (llth Cir. 1982); *King* v. *Winkler*, 673 F.2d 342, 345-346 (llth Cir. 1982); *Canfield* v. *Rapp & Son, Inc.*, 654 F.2d 459, 463-466 (7th Cir. 1981); *Frederiksen* v. *Poloway*, 637 F.2d 1147, 1150-1154 (7th Cir. 1981); and *Chandler* v. *Kew, Inc.*, 691 F.2d 443, 444 (10th Cir. 1977).

[2] See, *e.g.*, Easley, *Recent Developments In The Sale Of Business Doctrine*, 39 Business Lawyer 929 (1984); Thompson, *The Shrinking Definition Of A Security: Why Purchasing All Of A Company's Stock Is Not A Federal Security Transaction*, 57 N.Y.U.L. Rev. 225 (1982); Seldin, *When Stock Is Not A Security: The Sale Of Business Doctrine*, 37 Business Lawyer 637 (1982).

ARGUMENT

THE FEDERAL SECURITIES LAWS DO NOT APPLY TO PRIVATELY NEGOTIATED SALES OF ALL OF THE STOCK OF A CORPORATION WHEN THE STOCK IS TRANSFERRED AS AN INCIDENT OF AN UNLIMITED TRANSFER OF OWNERSHIP AND CONTROL OVER THE BUSINESS ENTERPRISE

I. This Court's Recent Decisions Construing The Term "Security" Strongly Support The Sale Of Business Doctrine

1. In their briefs in this Court, petitioner and the SEC depend heavily on lower court decisions, and give grudging mention to the three latest decisions of this Court defining the term "security." That is not surprising, since their theories are irreconcilable with those recent decisions. Unlike petitioner and the SEC, we begin with what this Court recently has said on the subject at hand.

a. This Court enunciated the contemporary approach to defining the term "security" in *United Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837 (1975). The plaintiffs in *Forman* alleged that "shares of stock" in a housing cooperative were investment securities subject to the federal securities laws. Plaintiffs claimed that because the shares were denominated "stock" and were purchased for value, they fell literally within the statutory definition of the term "security" and also constituted "investment contracts." In words that are directly applicable here, this Court rejected both contentions.

The Court began by observing generally that "stock" does not "fall within the ordinary concept of a security" unless it is sold "by those who seek the use of the money of others on the promise of profits." 421 U.S. at 848. Thus, the Court "reject[ed] at the outset any suggestion that the present transaction, evidenced by the sale of shares called 'stock,' must be considered a security transaction simply because the statutory

definition of a security includes the words 'any stock.'" *Ibid.* Rather, in considering the scope of the term "stock," the Court found it essential to place "emphasis * * * on economic reality." *Ibid.* Stated otherwise, "[b]ecause securities transactions are economic in character Congress intended the application of these statutes to turn on the economic realities underlying a transaction, and not on the name appended thereto." *Id.* at 849. Viewing the economic realities underlying the purchase of stock in *Forman,* this Court held that the plaintiffs, who sought to acquire real estate "for their personal use," were not, in fact, "purchasing investment securities" even though the transaction was evidenced by a sale of stock. *Id.* at 851.

When the Court in *Forman* turned next to plaintiffs' claim that the certificates constituted "investment contracts," it utilized the same "economic reality" test used in analyzing the question whether the certificates were "stock," emphasizing that "we again must examine the substance —the economic realities of the transaction— rather than the names that may have been employed by the parties." *Id.* at 851-852. The economic realities test required a careful analysis of whether "the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." *Id.* at 852. "This test, in shorthand form, embodies the essential attributes that run through *all* of the Court's decisions defining a security. The touchstone is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others." *Ibid.* (emphasis supplied).

Forman also announced the standard used to distinguish between security transactions and commercial transactions: "when a purchaser is motivated by a desire to use * * * the item purchased — 'to occupy the land or to develop it themselves' * * * — the securities laws do not apply." *Id.* at 852-853. Even though the purchasers in *Forman* had an economic motivation for acquiring the stock in question, this Court found that "that

type of economic interest characterizes every form of commercial dealing." It added that "[w]hat distinguishes a security transaction — and what is absent here — is an investment where one parts with his money in the hope of receiving profits from the efforts of others, and not where he purchases [an asset] * * * for personal use." *Id.* at 858.

Thus, because the economic reality of the transaction at issue in *Forman* was a purchase of property to be used by the purchasers themselves — rather than payment of money to a third party with the expectation of profit from the third party's entrepreneurial efforts — this Court declined to find a security transaction despite the presence of certificates labelled "stock."

b. Proper application of *Forman* in the present case is clear. Here, as in *Forman,* the fact that stock certificates changed hands is not dispositive. In construing the federal securities laws, the Court must assess the economic reality of the underlying transaction. Here, as in *Forman,* no one placed money in the hands of others with the expectation of profit from their managerial efforts and here, as in *Forman,* there was no common venture. Quite to the contrary, the purchaser acquired property to be used by itself. Unlike a true security transaction, the purchaser here did not part with control over its investment. The present transaction is no different from the countless other transactions in our commercial world in which a purchaser acquires property to be used for profit-making purposes and obtains a transferable certificate to evidence its right of ownership.

What *Forman* recognizes, and what the court below also recognized, is that documents evidencing an ownership interest can be transferred in two fundamentally different contexts. In the first situation, the purchaser obtains a document reflecting its right of ownership at the same time that it obtains exclusive possession of the underlying property. The document formalizes undivided ownership. Examples include purchases of real estate or chattels in which cash is exchanged for a transferable

deed of title. By contrast, a security transaction arises when the purchaser obtains a document representing a fractional equity interest at the same time that he places capital in the hands of managers who are expected to earn profits for investors at large.

In this case, as in *Forman,* the acquiring party received stock certificates merely to formalize its ownership of property that it intended to manage itself. And here, as in *Forman,* the certificates did not have the significant "characteristics" of securities in the hands of investors (*id.* at 851). While ordinary investors purchase stock to obtain "dividends contingent upon an apportionment of profits" (*ibid.*), the certificates here were acquired to serve the formal function of a bill of sale or deed of title. The purchaser's profits were not "contingent" on any "apportionment of profits" by managers, but on its own managerial efforts. Moreover, as in *Forman,* "voting rights" and market "appreciat[ion]" had nothing to do with this stock acquisition. *Ibid.* The purchaser acquired the sawmill not to vote shares or speculate in the stock market, but to make money cutting logs (J. App. 83).

It would be exalting form over economic substance to treat a sale of business such as this as a sale of investment securities. Here, the "stock * * * merely was passed incidentally as an indici[um] of ownership of the business assets." *Frederiksen* v. *Poloway,* 637 F.2d 1147, 1151-1152 (7th Cir. 1981). Since a sale of assets unquestionably would not be encompassed by the securities laws, the form of the transaction (ordinarily dictated by tax planning considerations) should not alter the result.

2. *a.* This Court's unanimous decision in *International Brotherhood of Teamsters* v. *Daniel,* 439 U.S. 551 (1979),

provides additional compelling reasons for sustaining the sale of business doctrine. In *Daniel,* the plaintiffs alleged that participations in an involuntary, noncontributory pension plan were securities. The financial interests in *Daniel* were part of the compensation package which the plaintiffs received as employees. The interests resembled interests in a commingled mutual fund and were managed by professional fiduciaries. In view of this, the plaintiffs in *Daniel* contended that the financial interests constituted an "investment contract" or a "participation in a profit-sharing agreement," both of which are contained in the definition of the term "security." This Court rejected both contentions.

Initially, the Court reiterated that the test "is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." 439 U.S. at 558. That test is to be applied "in light of 'the substance — the economic realities of the transaction — rather than the names that may have been employed by the parties.'" *Ibid.* The Court declined to find "any broader meaning" in any of the alternative definitions contained in the securities laws, since the economic realities test "embodies the essential attributes that run through *all* of the Court's decisions defining a security." *Id.* at 558 n. 11 (emphasis supplied).

The Court in *Daniel* then turned to the question whether it was realistic to view the plaintiffs' acquisition of pension plan interests as an investment in securities. The Court held that it was not, explaining that "[i]n every decision of this Court recognizing the presence of a 'security' under the Securities Acts, the person found to have been an investor chose to give up a specific consideration in return for a separable financial interest with the characteristics of a security." *Id.* at 559. In *Daniel,* by contrast, "the purported investment is a relatively insignificant part of * * * [the] * * * total and indivisible * * * package." *Id.* at 560. The "package" received by the plaintiff-

employees, viewed as a whole, "is substantially devoid of aspects resembling a security." *Ibid.*

In addition, the Court in *Daniel* found that the financial benefits expected by the plaintiff-employees were not dependent solely "on the efforts of the Fund's managers." *Id.* at 562. Rather, those financial benefits "would depend primarily on the employee's efforts to meet the vesting requirements." *Ibid.* Thus, the financial returns expected by the plaintiff-employees came from their own efforts and not "from the entrepreneurial or managerial efforts of others." *Id.* at 561.

Finally, this Court observed in *Daniel* that treating the employees' financial interests as securities was unnecessary to protect their rights. The Court explained that other remedial schemes, such as the Employee Retirement Income Security Act, provided ample protection and were preferable to "the indefinite and uncertain disclosure obligations imposed by the antifraud provisions of the Securities Acts." *Id.* at 569. Thus, extension of the federal securities laws to the transactions at issue would "serve[ ] no general purpose." *Id.* at 570.

b. Daniel confirms that the court of appeals correctly declined to expand the scope of the federal securities laws in this case. Here, as in *Daniel*, it is completely unrealistic to speak of petitioner's acquisition of a business enterprise as a purchase of "securities." Petitioner clearly did not "give up a specific consideration in return for a separable financial interest with the characteristics of a security." 439 U.S. 559. Unlike the ordinary investor, who obtains only stock certificates and does not obtain ownership and control of the underlying physical assets, the purchaser here acquired a business operation in its entirety.

In addition, here, as in *Daniel*, the profits expected by petitioner were to come not from the managerial or entrepreneurial efforts of "others" (*id.* at 561), but rather from petitioner's own efforts (*id.* at 562). Finally, here, as in *Daniel*, it is totally unnecessary to extend the "indefinite and uncertain

disclosure obligations imposed by the antifraud provisions of the Securities Acts" (*id.* at 569) because there is an alternative and superior remedial scheme. The parties have prescribed in detail precisely how their rights and obligations are to be measured in the 60-page sale agreement, which contains comprehensive and carefully negotiated covenants and warranties. In this context, application of the federal securities laws would "serve no general purpose." *Id.* at 570.

3. *a.* This Court's unanimous decision in *Marine Bank* v. *Weaver*, 455 U.S. 551 (1982), removes any remaining doubt about the correctness of the decision of the court below. The plaintiffs in that case alleged that sales of a "certificate of deposit" and a "business agreement" constituted securities transactions. The certificate of deposit contained a promise to repay a sum certain plus interest, and fell literally within the statutory definition of the term security, which embraces any "note." Likewise, the business agreement provided for a sharing of profits from a commercial enterprise managed by other persons. It therefore literally fell within the statutory definition, which embraces any "profit-sharing agreement" or "investment contract."

Applying the economic realities test, however, this Court concluded that neither financial interest constituted a security. In rejecting plaintiffs' expansive arguments under the securities laws, the Court warned that "we are satisfied that Congress * * * did not intend to provide a broad federal remedy for all fraud." 455 U.S. at 556.

Turning to the certificate of deposit, the Court stated that "[t]he definition of 'security' in the 1934 Act provides that an instrument which seems to fall within the broad sweep of the Act is not to be considered a security if the context otherwise requires. It is unnecessary to subject issuers of bank certificates of deposit to liability under the antifraud provisions of the federal securities laws since the holders of bank certificates of

deposit are abundantly protected under [other applicable] laws." *Id.* at 558-559.

The Court also concluded that the profit sharing agreement was beyond the scope of the securities laws. The Court acknowledged that "the agreement gave the [purchasers] a share in the profits of the slaughterhouse which would result from the efforts of the [sellers]." *Id.* at 559. Nonetheless, because the transaction was privately negotiated, it had none of the characteristics commonly associated with a securities transaction. The instruments "found to constitute securities in prior cases involved offers to a number of potential investors, not a private transaction as in this case." *Ibid.* The Court explained that "[h]ere, * * * the [sellers] distributed no prospectus to the [purchasers] or to other potential investors, and the unique agreement they negotiated was not designed to be traded publicly." *Id.* at 560.

Finally, the Court observed that the plaintiffs in *Marine Bank* were not mere passive investors who placed capital in the hands of managers. It noted that "the [contractual] provision that the [purchasers] could veto future loans gave them a measure of control over the operation of the slaughterhouse not characteristic of a security." *Id.* at 560. Accordingly, "this unique agreement, negotiated one-on-one by the parties, is not a security." *Ibid.*

b. The relevance of *Marine Bank* in present circumstances is apparent. Here, as in *Marine Bank*, it is essential to look beyond the language of the statutory definitions and to examine the transactional "context." That examination establishes that petitioner has ample protection for its financial rights without resort to federal court remedies under the securities laws. The contractual warranty provisions in the purchase agreement are enforceable under state law, not federal law.

In addition, this Court's conclusion that the business agreement in *Marine Bank* did not give rise to a security sale is

precisely applicable here. The agreement in *Marine Bank* provided for a partial transfer of business pursuant to a joint venture. The interest in the joint venture was not a security because the plaintiffs obtained a "veto" power over certain managerial decisions. In the present case, petitioner obtained not only some role in management — it obtained *all* managerial power. Moreover, in this case, as in *Marine Bank*, the privately negotiated agreement, calling for the transfer of assets and stock, was unaccompanied by any element of public distribution. It therefore follows that this "unique agreement, negotiated one-on-one by the parties," is beyond the scope of the securities laws. *Id.* at 560.

II. The Legislative History Confirms That Congress Did Not Intend To Treat Privately Negotiated Sales Of Businesses As Securities Transactions

As this Court explained in *Forman, supra*, 421 U.S. at 849:

> "The focus of the Acts is on the capital market of the enterprise system: the sale of securities to raise capital for profit-making purposes, the exchanges on which securities are traded, and the need for regulation to prevent fraud and to protect the interest of investors."

Indeed, the *only* relevant statutory objective expressed in the legislative history is protection of the financial interests of those who buy or sell investment instruments — *i.e.*, persons who earn profits from the managerial efforts of others. See Thompson, *The Shrinking Definition Of A Security, supra*, 57 N.Y.U.L. Rev. at 241: "The securities laws are meant to protect those who turn over their investments to third parties, not those who manage their investments themselves." As President Roosevelt stated in his message to the House of Representatives in March 1933: "What we seek is a return to a clearer understanding of the ancient truth that those who manage * * * corporations and other agencies handling or using other people's money are trustees acting for others." 77 Cong. Rec. 937 (1933). Thus, the Securities Act of 1933 sought to protect public investors by

regulating fiduciaries who solicited their funds (H.R. Rep. No. 85, 73d Cong., lst Sess. 5 (1933)):

> "The character of civil liabilities imposed by this bill are described elsewhere. Their essential characteristic consists of a requirement that all those responsible for statements upon the face of which the public is solicited to invest its money shall be held to standards like those imposed by law upon a fiduciary."

See also *id.* at 9-10; S. Rep. No. 47, 73d Cong., lst Sess. 5 (1933).

This exclusive focus on the plight of the passive investor, who must rely on fiduciaries to manage his capital, is evident in the words of Congressman Rayburn, a principal sponsor of the legislation (77 Cong. Rec. 2910, 2918 (1933)):

> "We have, on the one hand, 18,000,000 passive citizens having no actual contact with their companies; on the other hand, a few hundred powerful managers directing and controlling the destinies of the companies and the physical properties which they own. The owners of these symbols are entitled to know what the symbols represent. Those who are interested in purchasing these pieces of paper have the right to demand information as to the actual condition of the issuing company. Up to this time such information has depended on the grace of an entrenched management. These managers are truly trustees."

Moreover, Congressman Rayburn left no doubt about his understanding of the "ordinary concept of a security" (*id.* at 2917):

> "Today the owner does not possess actual physical properties but he holds a piece of paper which represents certain rights and expectations. [T]he owners of these pieces of paper have little control over the physical property; the owners of these pieces of paper carry no actual responsibility with respect to the enterprise or its physical property."

Thus, Congress sought to remedy problems resulting from the separation of ownership and management — not the purported problems of those who both manage and own.

The legislative history of the Securities Exchange Act of 1934 shows the same concern for the plight of the dependent investor. Congress intended to "regulate the stock exchanges and the relationship of the investing public to corporations which invite public investment." H.R. Rep. No. 1383, 73d Cong., 2d Sess. 2 (1934); accord, S. Rep. No. 792, 73d Cong., 2d Sess. 5 (1934). See also H.R. Rep. No. 1383, *supra*, at 4-5:

> "When corporations were small, when their managers were intimately acquainted with their owners and when the interests of management and ownership were substantially identical, conditions did not require the regulation of securities marke[t]s. * * * * [A]s management became divorced from ownership and came under the control of banking groups, men forgot that they were dealing with the savings of men and the making of profits became an impersonal thing."

Thus, as a "complex society so diffuses and differentiates the financial interests of the ordinary citizen that he has to trust others and cannot personally watch the managers of all his interests * * *, it becomes a condition of the very stability of that society that its rules of law and of business practice recognize and protect that ordinary citizen's dependent position" (*id.* at 5).

In short, the legislative history distinguishes clearly between passive investors and managers, and identifies the former as the "protected class." *Sutter* v. *Groen*, 687 F.2d 197, 201 (7th Cir. 1982):

> "The Committee's report contains a chorus of references to 'disastrous results to investors,' 'tremendous losses to the investing public,' 'losses incurred in speculative transactions,' 'severe financial losses sustained by investors,' 'the exploitation of the investor,' and on and on in this vein. * * * * No other protected class is mentioned; entrepreneurs are not mentioned."

There is not the slightest hint in the legislative history that Congress intended to bring into federal court the claims of businessmen who acquire entire corporations through privately negotiated transactions, who wield substantial bargaining power to demand disclosure of relevant information, and who prescribe by contract specific remedies for the protection of their economic interests. Such an expansion of the scope of the federal securities laws —with an accompanying displacement of contractual remedies— would clash with Congress' stated purpose "to protect the public with the least possible interference to honest business." H.R. Rep. No. 85, 73d Cong., lst Sess. 2 (1933).

This is not to say that only individual investors, and not business firms, may invoke the federal securities laws. Business firms frequently make investments, and when they do—whether they invest in securities traded on exchanges, over the counter, or in face-to-face transactions— they may claim the protection of the securities laws. See *United States* v. *Naftalin*, 441 U.S. 768 (1979). Common examples of such investments include stock transactions by brokerage houses, or purchases of debt securities by business firms seeking a return on surplus cash. However, when either a natural person or a business firm acquires all of the stock of a corporation by negotiated sale, not for investment but as a means to obtain ownership and control of the underlying physical assets, the transaction is commercial in nature and beyond the purview of the federal securities laws.

III. The Ninth Circuit's Decision Finds Direct Support In The Established Principle That Sales Of General Partnership Interests And Commercial Notes Do Not Constitute Securities Transactions

The decision of the Ninth Circuit finds direct and compelling support in the law which governs other closely-related types of economic transactions. For example, this Court has

recognized that a joint venture involving shared profits and managerial responsibility is not a security, despite the literal applicability of the statutory definition. See *Marine Bank, supra*, 455 U.S. at 559-560. The reason is that the purchaser of the joint venture interest has "a measure of control over the operation of the [business enterprise] not characteristic of a security." *Ibid.*

The lower federal courts consistently have applied that principle to hold that sales of general partnership interests, which grant the purchaser a share of profits and some measure of control over the business enterprise, are beyond the scope of the federal securities laws. See, *e.g.*, *Odom* v. *Slavik*, 703 F.2d 212, 215-216 (6th Cir. 1983) ("The managerial powers vested in general partners and the express right of inspection of documents gives them the kind of leverage and ability to protect themselves that takes them outside of the intended scope of the '34 Act"); *Williamson* v. *Tucker*, 645 F.2d 404, 417-425 (5th Cir. 1981); *Goodwin* v. *Elkins & Co.*, 730 F.2d 99, 102-108 (3d Cir. 1984).

The interests of general partners frequently are obtained by making capital contributions and also are assignable for value. See J. Crane & A. Bromberg, *Law of Partnership*, 130-131, 239-240 (1968). Nonetheless, the securities laws do not apply because "[p]artners are not passive investors who place money in an enterprise with the expectation of deriving profits solely from the efforts of others * * *. Rather, they expect to reap profits through their own active participation in the control and management of the business." R. Jennings & H. Marsh, *Securities Regulation* 308 (3d ed. 1972).

This rationale, which distinguishes general partners from investors, applies *a fortiori* to entrepreneurs who purchase a business enterprise for themselves and operate it unilaterally. To treat general partners and entrepreneurs differently would create a serious anomaly under the federal securities laws and would blink at economic reality.

It also is well established that instruments which are securities when offered in an investment context cease to be securities when transferred in a commercial context. In particular, this Court has recognized that an "unsecured note, the terms of which were negotiated face-to-face, given to a bank in return for a business loan, is not a security." *Marine Bank, supra*, 455 U.S. at 560 n. 10; accord, *Forman, supra*, 421 U.S. at 849 n. 14 (citing with approval *C.N.S. Enterprises, Inc.* v. *G. & G. Enterprises, Inc.*, 508 F.2d 1354 (7th Cir. 1974)). The lower courts are in agreement on this issue. See, *e.g., AMFAC Corp.* v. *Arizona Mall of Tempe*, 583 F.2d 426, 433 (9th Cir. 1978); *American Bank & Trust Co.* v. *Wallace*, 702 F.2d 93, 96-97 (6th Cir. 1983); *Chemical Bank* v. *Arthur Andersen*, 726 F.2d 930, 938-939 (2d Cir. 1984).

"Notes," of course, are securities embraced by the literal terms of the statutory definition when sold in an investment context. However, they cease to be securities when transferred in a face-to-face, privately-negotiated commercial transaction. This principle strongly supports the sale of business doctrine. As the court of appeals explained (Pet. App. 8a-9a): "We see no principled way to justify an analysis in which we determine whether a note is a 'security' within the meaning of the Acts by examining the transaction in light of the statutory purpose, but determine whether stock is a 'security' by examining only the instrument and not the transaction * * *. We therefore conclude that adherence to the principle of construction adopted in our 'note' cases requires adherence to the 'sale-of-business' exclusion from the Securities Acts of the purchase of 100% of the stock of [a] closely-held corporation." Stock certificates, like notes, take countless forms and are transferred in many different contexts. There is no reasonable basis for applying different legal principles to them under the same statutory definition.

In this case, both individually-negotiated promissory notes and unregistered shares of stock changed hands in the same sale of business (J. App. 206-207). Nobody would seriously

contend that the "notes" in this transaction were "securities" merely because they fell within the literal terms of the statutory definition. And it is equally unreasonable, in the context of this purely commercial transaction, to so designate the shares of stock, or to seize upon the label affixed to them as a pretext for bootstrapping this state-law controversy into federal court.

IV. The Ninth Circuit's Decision Finds Direct Support In This Court's Repeated Pronouncement That The Federal Securities Laws Should Not Be Construed Broadly To Supersede Traditional State Law Remedies

The parties to the sale of business contract in this case specifically tailored their agreement to include warranties and covenants prescribing their respective rights, which were enforceable under state contract law. The very same claims now asserted by petitioner in federal court also have been asserted in a pending state law complaint.[3] Such claims traditionally have been relegated to state tribunals, and there is no good reason why federal courts should hear such cases and permit a totally unnecessary expansion of federal jurisdiction.[4]

[3] In this context, as in *Forman*, after-the-fact claims of "reliance" on the federal securities laws are wholly unavailing. A party which negotiates an agreement that prescribes detailed and comprehensive contract remedies should not later be heard to argue that it was led "justifiably to assume" that the federal securities laws would govern those same disputes. *Forman, supra*, 421 U.S. at 850.

[4] State law remedies, including remedies based upon contract and deceit, are specifically adapted and fully adequate to protect the purchaser of a business enterprise, who can quickly identify defects in assets or financial condition and invoke governing warranties and covenants after obtaining control of the business. See page ii, *supra*. See also *SEC* v. *Capital Gains Bureau, Inc.*, 375 U.S. 180, 194-195 (1963), observing that common law "doctrines of fraud and deceit" are specifically adapted to controversies concerning "tangible items of wealth," as opposed to "such intangibles as * * * securities."

The availability of adequate state law remedies is an additional and compelling reason for declining to adopt the expansive construction urged by petitioner. See *Santa Fe Industries, Inc.* v. *Green,* 430 U.S. 462, 477-480 (1977) (declining to "bring within [the securities laws] a wide variety of corporate conduct traditionally left to state regulation"). *Green* held that undue "extension of the federal securities laws would overlap and quite possibly interfere with state corporate law," and observed that "[a]bsent a clear indication of congressional intent, we are reluctant to federalize the substantial portion of the law of corporations that deals with transactions in securities * * *." *Green* explicitly declined to extend the federal securities laws "to 'cover the corporate universe.'" *Id.* at 479-480. Accord, *Piper* v. *Chris-Craft Industries, Inc.,* 430 U.S. 1, 40-41 (1977); *Forman, supra,* 421 U.S. at 859 n. 26; *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 738 n. 9 (1975).[5]

As this Court admonished in *Marine Bank, supra,* it is essential to bear in mind that Congress "did not intend to provide a broad federal remedy for all fraud." 455 U.S. at 556. That admonition is relevant here, and weighs heavily against creation of a new federal remedy that could serve "no general purpose." *Daniel, supra,* 439 U.S. at 570.

V. The Sale of Business Doctrine Prevents Parties From Breaching Their Contractual Obligations And Deters Vexatious Litigation

In resolving the question of interpretation presented in this case, the Court should bear in mind the motivation for resorting to securities litigation in sale of business controversies. The

[5] The state law principles applicable to a sale of business controversy place a burden of proving reasonable care on purchasers alleging deception and give full effect to contractual remedies and limitations on liability. See *Grumman Allied Industries, Inc.* v. *Rohr Industries, Inc.,* 748 F.2d 729, 730-740 (2d Cir. 1984). A federal securities law remedy would run roughshod over these established state law principles, as discussed immediately below.

securities laws are invoked because they confer a very substantial advantage on the plaintiff. As this Court observed in *Wilko* v. *Swan,* 346 U.S. 427, 435 (1953), "the Securities Act was drafted with an eye to the disadvantages under which buyers labor." This Court's decisions have accordingly construed the securities laws liberally to minimize procedural and substantive burdens recognized at common law. See, *e.g., Herman & MacLean* v. *Huddleston,* No. 81-680 (Jan. 24, 1983), slip op. 13. The quest for liberal remedies is evident in petitioner's reliance on Section 12(2), 15 U.S.C. 77*l* (2), of the Securities Act of 1933. That provision permits the plaintiff to argue that the burden of proof should be shifted from the plaintiff to the defendant, who must establish that any omitted fact could not have been discovered and disclosed through the exercise of reasonable care. Compare note 5, *supra.*

While it is reasonable to suppose that Congress intended to grant these liberal remedies to investors to overcome the "disadvantages" described in *Wilko,* there is no reason to suppose that Congress wished to favor one side rather than another in a sale of business transaction. Certainly, wealthy businessmen and sophisticated lawyers purchasing a corporation have no claim to special protection when compared to the proprietors of a family-owned sawmill. In a case such as this, each side of the controversy is in a position to bargain effectively, and each side is free to contract —with the aid of counsel—to secure precisely the protection which it requires.

Conferring special substantive and procedural advantages on one party in a sale of business controversy is an invitation to serious abuse. As this Court emphasized in *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 739-743 (1975), "[t]here has been widespread recognition that litigation under Rule 10b-5 presents a danger of vexatiousness ***. [I]n the field of federal securities laws governing disclosure of information even a complaint which by objective standards may have very little chance of success at trial has a settlement value to the plaintiff

out of any proportion to its prospect of success ***. The very pendency of the law suit may frustrate or delay normal business activity * * * ." The *in terrorem* threat of burdensome litigation in federal court, with extensive discovery and only a limited possibility of resolution by summary judgment, gives the plaintiff substantial leverage to coerce a settlement and thereby reduce the purchase price. See pages i-iv, *supra.*

Federal court litigation under the securities laws permits the plaintiff to ignore the sale contract, with its specific covenants, warranties, procedures, and designation of governing law. See Add., *infra,* at A-6 to A-24. It permits the plaintiff to allege a host of "nondisclosures" after obtaining possession of the business, and to contend that each such omitted fact constituted a fraud, notwithstanding its own failure to carefully investigate. In every commercial transaction of this magnitude and complexity, it is possible to find some fact concerning the operation of the transferred business which was not "disclosed," particularly when the purchaser bargains for and receives only certain information during its due diligence investigation. Such a claim of nondisclosure permits the plaintiff to insist upon a trial by jury to resolve factual issues of "materiality" and "scienter," while effectively nullifying covenants providing that only specific warranties and representations are "of the essence." See Add., *infra,* at A-23.

Recognition of a securities action in this context invites other abuses. A liberal remedy in federal court encourages the purchaser to over-extend itself in a leveraged acquisition, to operate the newly-acquired company at great risk, and, if the company does not prove to be profitable or if interest payments cannot be met, to demand either a reduction in the purchase price or rescission. See pages i-iv, *supra;* see also *Condux* v. *Neldon,* 404 N.E.2d 523, 526, 530-531 (Ill. App. 1980), which applied this Court's decision in *Forman* and adopted the sale of business doctrine:

> "The rights the plaintiffs claim would be manifestly open to abuse. A buyer, once in control of the corporation, would find it to his advantage to gamble with it, to take abnormal risks, knowing that any profits will be his while any losses can be unloaded onto the seller. The buyer would have an incentive to manage his business imprudently; the helpless seller, who thought he was disposing of his business, would find himself indefinitely dependent on its fortunes, now at the mercy of a buyer of unknown skill and honesty, over whom the seller has no control. The seller, in fact, would be in the sort of position the securities laws attempt to protect buyers against. * * * * *. The [securities] laws, we reiterate, are a shield between the promoter and the sucker, not a sword with which the merely unskillful or unlucky businessman may oppress his predecessors."

Perhaps the most oppressive and unfair tactic which the sale of business doctrine serves to prevent is the tactic of renouncing an express agreement to arbitrate. Complex sale of business controversies are ideally suited for arbitration. See *Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.,* 388 U.S. 395 (1967). However, to the extent that a purchaser or seller in a sale of business controversy files suit under the federal securities laws, the unscrupulous plaintiff can contend (as in the *Algeran* case) that the arbitration agreement is a nullity. See *Wilko* v. *Swan, supra,* 346 U.S. at 438. See also pages i-iv, *supra;* Add., *infra,* at A-2 to A-3, A-23 to A-24.

It is no exaggeration to say that superimposing conflicting securities law remedies upon contractual remedies negotiated by the parties is a frontal assault on the principle of freedom of contract which long has been applied to dealings between sophisticated businessmen of equal bargaining power. Such a result cannot be reconciled with this Court's repeated declaration that the securities laws should not be broadly construed to permit "vexatious" litigation (*Blue Chip Stamps, supra,* 421 U.S. at 739). See *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185, 214-215 n. 33 (1976) ("the inexorable broadening of the class

of plaintiffs who may sue in this area" may "ultimately result in more harm than good").

VI. No Persuasive Policy Argument Has Been Advanced For Rejecting The Sale Of Business Doctrine

The SEC, in a series of *amicus curiae* briefs filed in the lower courts, has campaigned against the sale of business doctrine and it has now taken the same position in this Court. The SEC's arguments, which conflict with arguments previously presented by the SEC to this Court, are devoid of merit and should be rejected.[6]

[6] The SEC's arguments conflict with arguments previously presented to this Court in its *amicus* brief in *Marine Bank* v. *Weaver*, No. 80-1562, at 8-10, 18-19, 25-26, and 26-29. In that brief, the SEC conceded that both a certificate of deposit and a profit sharing agreement were beyond the scope of the securities laws, despite the literal applicability of the statutory definitions. The SEC acknowledged that it is necessary to look beyond the definitional language "in those cases in which there is evidence that transactions of the type at issue were not intended to come within the scope of the statute" (*id.* at 10 n. 11); that the term "security" must be construed in light of Congress' intent to avoid regulating those "types of securities and securities transactions where there is no practical need for [the statute's] application or where the public benefits are too remote" (*id.* at 26); that the analysis of economic "context" required by the securities laws includes "the surrounding factual circumstances" (*id.* at 8); that "[i]t was the interest of investors [as opposed to parties to commercial contracts] that required special protection under the securities laws" (*id.* at 18); and that Congressional intent to exclude a controversy from the scope of the securities laws could be inferred from Congress' recognition that persons in the position of the plaintiff, on the one hand, and "investors," on the other, were properly "viewed as standing in fundamentally different positions" (*id.* at 18). As demonstrated in this brief, application of those principles—previously endorsed by the SEC—leads inescapably to the conclusion that the court below correctly adopted the sale of business doctrine. The SEC's abandonment of those principles in this litigation removes any presumption in favor of its proffered interpretation. See *Forman, supra*, 421 U.S. at 858-859 n. 25; *Daniel, supra*, 439 U.S. at 566 n. 20.

The Commission's principal policy argument (Br. 21-24) is that the sale of business doctrine should be rejected because it will precipitate the judiciary down a "slippery slope." If sales of 100% of a company's stock are not covered by the securities laws, how will the judiciary grapple with cases involving sales of 75% or 51%? The short and sufficient answer to that argument is that the present case —involving a 100% stock sale accompanied by an unlimited transfer of control— involves no such complexities. The present case calls for a decision on its own record.[7]

Beyond this, federal courts which have implemented this Court's "economic realities" test have experienced no difficulty in applying it in other contexts. Thus, they have faithfully adhered to the principle that "[e]ach transaction must be analyzed and evaluated on the basis of * * * the factual setting as a whole." *Marine Bank, supra*, 455 U.S. at 560 n. 11. Where, as an objective matter, a purchaser negotiates for the acquisition of a majority of the stock of a corporation in a private transaction, installs a majority of the board of directors, and proceeds to earn profits by guiding the operations of the acquired corporation, the "economic realities" test properly is applied to preclude federal court jurisdiction. See Easley, *Recent Developments in the Sale of Business Doctrine*, 39 Business Lawyer 929, 951-953, 966-975 (1984).

Judge Posner's explanation of the practical aspects of applying the "economic realities" test in such a case, as set forth in *Sutter* v. *Groen*, 687 F.2d 197, 202 (7th Cir. 1982), is

[7] References to other cases involving their own economic circumstances, which may or may not be governed by the Court's decision here, are not a valid basis for extending the federal securities laws in this case far beyond the intent of Congress. Moreover, a decision from this Court holding that private sales of all identifiable stock of a corporation are beyond the scope of the securities laws could be applied by the lower federal courts with efficiency and would mitigate their already excessive workload. See pages i-iv, *supra;* see also Add., *infra*, at A-1 to A-3.

especially pertinent: "We agree that the costs of administering legal rules are a proper concern * * *. But rarely will a net saving in those costs be produced by expanding liability since even if the legal standard will be simpler and therefore cheaper to apply in each case, the number of potential cases in which it will be applied will be greater." Judge Posner added that even if a rigid and literal approach to the definitional issue offered "some net cost savings, we doubt they could justify expanding liability to reach substantive evils far outside the scope of the legislature's concern." *Ibid.*[8]

The legal issues raised in a sale of business case are no more complex than those raised in the many other cases cited by the SEC (Br. 18 n. 18), which also require an examination of economic realities. The controlling principle in all such cases is the same as that which governs here: the securities laws apply when the plaintiff places money in the hands of others with the expectation of profit deriving from their managerial efforts; they do not apply when the substance of the transaction is an outright acquisition of economic resources to be managed by the plaintiff himself.

We also submit that there is no merit to the SEC's suggestion (Br. 8-10) that acceptance of the "economic realities" test in cases such as this reduces all types of securities to "investment contracts," which originally were analyzed under that standard. It is a *non sequitur* to argue that because all types of securities described in the statutory definition are recognized to have a common economic characteristic — investment of money in a joint enterprise with profits stemming from the efforts of others— that differences between distinct types of securities are therefore eliminated. Under the economic realities test, each type of security retains its special attributes (*e.g.*, stocks are equity investments, bonds are secured debt investments, notes are unsecured debt investments, etc.) even though every security has a common economic feature. Accordingly, this Court need not hesitate to accept the sale of business doctrine based on the erroneous assertion that such a ruling would blur traditional differences between the categories of securities enumerated by Congress.

[8] Courts which accept the sale of business doctrine properly have declined to extend it to transfers of control involving widespread solicitation of public investors. See *McGrath* v. *Zenith Radio Corp.*, 651 F.2d 458, 467-468 n. 5 (7th Cir. 1981). Such transactions, in contrast to the transaction at issue in the present case, clearly do implicate "the legislature's concern." See pages 14-18, *supra*.

The SEC also argues (Br. 12-13) that, because Congress did not expressly state that privately negotiated transfers of 100% of a company's stock are beyond the scope of the securities laws, federal courts are powerless to examine the economic realities of such transactions. This argument ignores Congress' unambiguous declaration that the securities laws should not be applied literally if the "context" indicates otherwise. In *Marine Bank*, this Court held that the statutory language refers to economic context, and not merely statutory context. 455 U.S. at 555-560. In so holding, the Court followed the SEC's brief *amicus curiae*, which argued that "[t]he word 'context,' which Congress deliberately selected, refers to the surrounding factual circumstances" (No. 80-1562 Amicus Br. at 8). As the SEC explained, "[i]f * * * the context of a given transaction so requires, a literal application of the statutory definition should be subordinated to Congress' underlying intent. Effectuation of the intention of the legislature remains the touchstone" (*id.* at 9-10). Thus, a careful contextual analysis, which includes "the interrelated conditions in which something * * * occurs" (*id.* at 8 n. 8), is essential because "a thing may be within the letter of the statute and yet not within the statute, because not within its spirit * * *" (*id.* at 9).

The very purpose of this contextual approach is to avoid a wooden construction that would extend the securities laws beyond Congress' intent and upset "the balance between state and federal responsibility." *Forman, supra*, 421 U.S. at 859 n. 26. This Court's recent decisions establish that rigid literalism is

not appropriate in cases involving a "stock certificate" (*Forman*), or a "long-term debt obligation," "investment contract," or "certificate of * * * participation in any profit-sharing agreement" (*Marine Bank*). In such instances, the Court uniformly has required a analysis of economic reality. There is no ground for departing from that standard here.

To be sure, "[t]here may be occasions when the use of traditional names such as 'stocks' or 'bonds' will lead a purchaser justifiably to assume that the federal securities laws apply." *Forman, supra,* 421 U.S. at 850. But this will follow only if "the underlying transaction" embodies the economic substance of a securities transaction. *Id.* at 851. Such an assumption plainly is not justifiable when a sophisticated purchaser negotiates for the acquisition of an entire business, and bargains for and obtains specific covenants and warranties to protect its financial interest under state law. In such a situation, the justifiable expectation of both parties is that the comprehensive sale agreement, enforceable under state law, prescribes the rights and remedies of the parties. To permit one party to cast aside that negotiated contract by resort to securities litigation in federal court would seriously undermine the principle of freedom of contract—a principle which is of paramount importance in dealings between sophisticated businessmen and which Congress did not intend to disturb.

CONCLUSION

The decision of the court of appeals should be affirmed.

Respectfully submitted.

STEPHEN M. SHAPIRO*
DAVID M. MICHAELSON
GEORGE V. BOBRINSKOY, JR.
JAMES J. JUNEWICZ
Mayer, Brown & Platt
231 S. LaSalle Street
Chicago, Illinois 60604
312-782-0600

BARBARA A. REEVES
DONALD I. BERGER
Morrison & Foerster
333 S. Grand Avenue
Los Angeles, California 90071
213-626-3800

* *Counsel of Record*

ADDENDUM

UNITED STATES DISTRICT COURT

Central District of California

ALGERAN, INC.,
Plaintiff,

v.

ADVANCE ROSS CORP., et al.,
Defendants.

The Court, having heard argument from counsel on April 30, 1984, with respect to defendants' motion for reconsideration, and having considered the points and authorities and declarations submitted therewith,

HEREBY ORDERS that pursuant to Local Rule 7.16(a) this is a proper motion for reconsideration as there is now a material difference in law which did not exist at the time this Court considered the original motion to dismiss. In reconsidering the motion, the Court regards it as a motion for summary judgment as there are matters outside of the pleadings which have been submitted and considered by the Court.

After considering the Ninth Circuit's recent decision in *Landreth Timber Co.* v. *Landreth,* ____ F.2d ____ (March 7, 1984) the Court grants summary judgment in favor of defendants as to Counts I-IV. Although plaintiff and counter-defendants argue that material questions of fact exist which preclude summary judgment, the Court disagrees. The Court finds that plaintiff's purchase of AMI was not a mere passive investment and the plaintiffs were not so dependent upon the existing AMI management for their profits that they could not replace it or exercise ultimate control. *See Gordon* v. *Terry,* 684 F.2d 736 (11th Cir. 1982), *reh'g. denied,* 690 F.2d 907, *cert. denied,* ____ U.S. ____ (1983).

The Court finds that Algeran, Inc., purchased AMI's existing management when it purchased AMI, and Advance

Ross Corp. had no control over AMI or its management after the sale.

In denying the original motion to dismiss, the Court ruled that as a matter of law the sale-of-business doctrine did not apply in this Circuit. Since then, however, the Ninth Circuit has adopted the doctrine in the *Landreth* case. The Court believes that the application of *Landreth* to the undisputed facts of this case requires summary judgment in favor of the defendants as to the federal securities claims. Pursuant to *Hamilton Jewelers v. Department of Corporation*, 37 Cal. App. 3d 330 (1974), the Court grants summary judgment in favor of defendants as to the state securities claims.

The Court finds that the notes issued to defendants by plaintiffs are not securities because they do not represent a contribution of "risk capital subject to the entrepreneurial efforts of others." *Amfac Manufacturing Corp.* v. *Arizona Mall of Tempe*, 583 F.2d 426, 432 (9th Cir. 1978).

The Court rejects plaintiff's claim that because it is in bankruptcy it cannot be compelled to arbitrate its claims. This is not the case in which a plaintiff/creditor is seeking to recover a judgment from a defendant/debtor. Here, Algeran, Inc. is the plaintiff seeking to rescind an agreement it entered into. Defendants are simply defending on the claims. The Court believes it would be manifestly unfair to allow plaintiff to use the bankruptcy system as a shield but at the same time permit it to use the federal courts as a sword. Plaintiff voluntarily chose to file suit in federal court and must therefore expect to suffer any possible adverse consequences by doing so. The Court believes that *Johnson* v. *England*, 356 F.2d 44 (9th Cir. 1966) and *Braniff Airways, Inc.* v. *United Airlines, Inc.* (In re Braniff Airways, Inc.) 33 Bankr. 33 (Bankr. N.D. Tex. 1983) do not compel a different result.

The Court further finds that defendants have not waived their right to arbitration either because of filing a suit in Illinois

or in having undertaken some discovery. The Court further believes that plaintiff and counterdefendants' argument that any possible stay will result in unnecessary delay, procedural confusion and potential inconsistent results is incorrect. On the contrary, the Court believes that arbitration may well be the speediest method of resolving the claims in this case.

The Court orders that the remaining claims in the complaint as well as other claims, i.e., counterclaims, be stayed pending arbitration of the non-security claims in the complaint, i.e., Counts V-VII. The Court believes that ¶8.04 of the Agreement requires that these claims be arbitrated. The Court reads ¶ 8.04 in conjunction with ¶ s 8.02 and 2.25 and concludes that plaintiff's claims are disputes and controversies relating to the interpretation of the contract. *See Mediterranean Enterprises, Inc.* v. *Sangyong Corp.*, 708 F.2d 1458 (9th Cir. 1983).

As to the argument that there is an $800,000.00 limit of recovery in the Agreement, the Court leaves it to the arbitrator to interpret the Agreement.

IT IS FURTHER ORDERED that this case is removed from the Court's active caseload until further application by the parties or Order of this Court.

IT IS FURTHER ORDERED that counsel are to file a joint status report on a quarterly basis beginning on October 1, 1984.

IT IS FURTHER ORDERED that defendants shall file proposed Findings of Fact and Conclusions of Law and a Judgment by May 29, 1984.

DATED: This 15th day of May, 1984.

/s/ DAVID V. KENYON
David V. Kenyon
United States District Judge

[EXCERPTS FROM]

AGREEMENT FOR SALE OF STOCK

This AGREEMENT FOR SALE OF STOCK is made and entered into as of the 15th day of December, 1982, by and between ADVANCE ROSS CORPORATION, a Delaware corporation, its wholly owned subsidiary, AD ROSS CORPORATION, a Delaware corporation (collectively referred to herein as "Seller"), and ALGERAN, INC., a California corporation ("Buyer"), with respect to Seller's shares of stock in AMI INDUSTRIES, INC., a Colorado corporation ("Company").

WHEREAS, Seller owns 406,786 shares (the "Shares") of the Company's $0.50 par value Common Stock, representing 96.637 percent of the issued and outstanding shares of stock in the Company, and

WHEREAS, Seller desires to sell, and Buyer desires to purchase all of Seller's Shares,

IT IS HEREBY AGREED:

ARTICLE I

AGREEMENT OF SALE AND PURCHASE

1.01 *Sale of Stock.* Seller agrees to sell and Buyer agrees to purchase all of the Shares, as provided in this Agreement.

1.02 *Purchase Price.* In consideration for the sale of the Shares, Buyer agrees to pay to Seller the sum of $8,000,000.00 (the "purchase price"). The purchase price was negotiated on the basis of (a) total stockholder's investment in the Company as of June 30, 1982, as reflected in the Company's June 30, 1982 consolidating balance sheet with Seller, plus (b) the amount of the long-term debt owed by the Company to Seller as of the June 30, 1982 consolidating balance sheet with Seller, less (c) the current and long-term notes receivable from

Regent/Pearne. The total of the foregoing amounts on June 30, 1982 was $7,081,612.

1.03 *Payment of Purchase Price.* The purchase price shall be paid in the following manner:

(a) At the Closing (as defined in Section 4.01 below) Buyer shall pay the sum of $5,300,000.00

* * *

(b) At the Closing, Buyer shall deliver four promissory notes (the "Notes"), executed by Buyer as maker and payable to Seller or order. The Notes shall be in the following principal amounts and maturity dates:

(i) $200,000.00 due one year after the Closing Date;

(ii) $350,000.00 due two years after the Closing Date;

(iii) $600,000.00 due three years after the Closing Date; and

(iv) $1,550,000.00 due four years after the Closing Date.

* * *

1.04 *The Notes.* Each of the Notes shall bear interest on the unpaid principal balance at twelve percent (12%) per annum, payable quarterly.

* * *

1.05 *Security for the Notes.* Payment of the Notes will be secured pursuant to a Security and Pledge Agreement providing, among other things, * * * (i) that the security shall consist of an assignment of Buyer's interest in and to the oil and gas revenues of its wholly-owned subsidiary, Algeran-Savage Corporation (subordinate only to the rights of Union Bank) and a pledge of the [AMI] Shares.

* * *

ARTICLE II

Warranties of Seller

Seller does hereby warrant and represent to Buyer as follows:

2.01 *Due Organization of the Company.* The Company is and will be at the Closing Date a corporation duly incorporated and validly existing under the laws of the State of Colorado; is and will be at the Closing Date in good standing under the laws of the State of Colorado; is not and will not as of the Closing Date be required to be qualified to do business in any other state or jurisdiction where the failure to be qualified would result in a liability for the Company in excess of $10,000.00; has neither property nor employees in any state other than Colorado, except as described by name or other specific description and address in SCHEDULE 2.01; has and will have at the Closing Date all requisite corporate power and authority to own its properties and carry on its business as now conducted; and has and will have at the Closing Date received no notice that it has not obtained all licenses, permits, or other authorizations, nor failed to take any actions, required by applicable law or governmental regulations in connection with its business as now conducted.

2.02 *Validity of Agreement.* The execution and delivery of this Agreement and consummation of the transactions contemplated hereby will not violate any provision of any Articles of Incorporation, By-Laws, agreement, mortgage, lien, lease, instrument, order, judgment or decree to which the Seller or the Company are a party or by which either of said entities are bound, and shall not violate any other restriction of any kind or character to which either of said entities are subject.

2.03 *Financial Statements.* Seller has delivered to Buyer (a) Seller's annual report for its year ended December 31, 1981; (b) Seller's unaudited first quarter report for the period

ended March 31, 1982; and (c) the Company's unaudited financial statements, including, among others, consolidating balance sheet and consolidating statements of income for the months ended June 30, 1982, July 31, 1982, August 31, 1982, September 30, 1982 and October 31, 1982. A true and correct copy of the Company's consolidating balance sheet for the month ended June 30, 1982 is attached hereto as SCHEDULE 2.03. All of the foregoing financial statements present fairly for purposes of consolidation with Advance Ross Corporation's financial statements the financial condition of the Company on the dates thereof and the results of operations for said periods, in conformity with generally accepted accounting principles applied on a consistent basis, except (i) for the change in 1980 to the method of determining inventory costs as described in Note B to the consolidated financial statements of Advance Ross Corporation for the year ended December 31, 1981; and (ii) that they do not give effect to certain adjustments and reclassifications that will be made in the audited financial statements of the Company referred to in Section 5.01(a) of this Agreement. The adjustments and reclassifications referred to in the foregoing clause (ii) will not reduce the Company's total stockholder's investment as shown in the Company's June 30, 1982 financial statements. As of the Closing Date, the amount of the Company's total stockholder's investment plus current and long term debts to Seller, less the current and long term notes receivable from Regent/Pearne will total no less than that shown on the June 30, 1982 financial statements except that changes in the principal amount of intercompany debt will be reflected in adjustments to the Note provided for in Section 1.03(b)(iv).

2.04 *Patents, Copyrights, Trademarks, Tradenames, Servicemarks, Licenses, and Manufacturing Processes.* The Company is the sole owner of the patents, patent applications, inventions, disclosures, copyrights, trademarks, tradenames and licenses listed and described in SCHEDULE 2.04. Except to

the extent, if any, set forth in SCHEDULE 2.04, such patents, patent applications, inventions, disclosures, copyrights, trademarks, tradenames and licenses are valid and in good standing, are subject to no liens or charges and are not involved in any interference, opposition or cancellation proceedings.

* * *

2.05 *Real Property.* SCHEDULE 2.05 contains a list of all real property owned by the Company or in which the Company has a leasehold or other interest. Such Schedule also contains a substantially accurate legal description of all such real property, and a description of all claims, liens and encumbrances against the Company's interest in all such real property.

2.06 *Title to Properties.* The Company has good marketable title to its properties and assets free and clear of all claims, liens, and encumbrances except for those matters which are disclosed in SCHEDULE 2.06.

2.07 *Tax Returns.* The Company, either alone or in conjunction with the filing of consolidated tax returns with Seller, has timely filed or caused to be filed, and has paid or accrued all taxes which have become due pursuant to such returns, all federal, state and local tax returns for income taxes, franchise taxes, sales and use taxes, withholding and all payroll taxes, property taxes, and all other taxes of every kind whatsoever required by law to have been filed, and all such tax returns are complete and accurate. For the purpose of the preceding sentence, a return shall be deemed to be timely filed if it is filed after the due date within any period allowed in an extension granted by the taxing authority. All of the Seller's and the Company's estimated tax deposits required to be paid prior to the Closing Date have been or will have been timely paid.

* * *

2.08 *Capitalization.* The Company is authorized to issue two classes of stock, consisting of 2,000,000 shares of common

stock having a par value of $0.50 per share and 1,000,000 shares of preferred stock having a par value of $1.00 per share. There are 420,944 common shares outstanding, and no more are presently issued and outstanding. No preferred shares have been issued. Seller owns, beneficially and of record, free and clear of all liens, charges, claims, equities, restrictions, or encumbrances 406,786 common shares, representing 96.637% of the outstanding and issued shares of the Company. There are no options or warrants outstanding to acquire any of the Shares nor any of the authorized but unissued shares of stock in the Company, and the Company is not subject to any agreement, express or implied, which would require it to issue any additional shares of stock. Seller has no knowledge indicating that any of the outstanding shares of the Company were not duly and validly issued in compliance with all applicable laws and regulations or that they are not fully paid and nonassessable. Seller has full right, power and authority to sell the Shares to Buyer as provided in this Agreement. Prior to Seller's acquisition of the Shares, the Company's shares were publicly traded and the Company was required to file reports pursuant to the Securities Exchange Act of 1934 (the "Act"), as amended. Seller has caused the Company to take such actions as were necessary to terminate the Company's reporting requirements under the Act, and the Company is not now and will not as of the Closing Date, be a reporting company under the Act.

2.09 *Litigation.* Except as set forth in SCHEDULE 2.09, neither Seller nor the Company has been served with any summons, complaint, or notice to arbitrate, and none of Seller's officers nor the Company's officers have any knowledge of any suit or action (equitable, legal or administrative), arbitration or other proceeding (including any formal or informal governmental investigation), pending or threatened in any way involving the Company or which relates to the Company's properties, business, assets, or prospects, or with respect to

which the Company, Seller, any of Seller's officers or any of the Company's officers has knowledge whereby as a result of the judgment or decision therein the Company may become legally obligated to discharge all or part of the judgment.

* * *

2.10 *Buildings and Equipment.* All buildings and equipment used or occupied by the Company are in good repair and operating condition, and Seller has no knowledge indicating that any such buildings or equipment fail to conform with all applicable ordinances, regulations and zoning laws.

2.11 *Material Contracts.* Except as listed in SCHEDULE 2.11, the Company is not a party to any written or oral: (a) contract for the employment of any officer or individual employee; (b) contract for the purchase of materials, supplies, services, machinery, or equipment involving payment by the Company of more than $10,000 in each case, or more than $25,000 in the aggregate with any one contracting party; (c) contract continuing over a period of more than one year from the date hereof; (d) material contract not terminable on thirty (30) days' notice or less without liability on the part of the Company; (e) material distributor, sales agency, or advertising contract, or contract for the sale of its products or services; (f) lease; (g) material contract with any subcontractor; (h) stock purchase, stock option, hospitalization, insurance or similar plan or practice, formal or informal, in effect with respect to its employees or others; (i) consignment agreement; or (j) contract not made in the ordinary course of business. SCHEDULE 2.11 also contains a true and complete schedule of all other material contracts and agreements to which the Company is a party. For purposes of this section, the term "material contract" excludes purchase or sale contracts involving less than $10,000.00, individually. True and complete copies of all contracts listed in SCHEDULE 2.11 requested by Buyer shall be delivered to Buyer upon demand.

* * *

2.12 *Insurance Policies.* Attached hereto as SCHEDULE 2.12 is a list of the insurance policies and bonds owned by the Company.

2.13 *Liabilities.* The Company does not have any liabilities of a kind generally described on a balance sheet (including notes thereto) in accordance with generally accepted accounting principles, whether accrued, absolute, contingent, or otherwise, and whether due or to become due, known or unknown, except (a) Liabilities set forth on the October 31, 1982 financial statement and (b) Liabilities that have been incurred in the ordinary course of business of the Company since October 31, 1982; or (c) Liabilities disclosed on SCHEDULE 2.13.

2.14 *Power to Enter Into Agreement.* This Agreement has been approved by resolution of Seller's Board of Directors, and no remaining corporate action or third party action is required to make this Agreement binding upon Seller.

2.15 *Accounts Receivable.* The accounts receivable as shown on the October 31, 1982 financial statement and that will exist as of the Closing Date, have arisen, or will have arisen, out of materials furnished or services performed. Seller has no knowledge indicating that any such accounts receivable will not be collectible in full on or before November 30, 1983.

2.16 *Inventory.* The inventory on hand as of the Closing Date is not and will not be obsolete or unusable in any material respect as of the Closing Date, and is saleable in the ordinary course of the business of the Company, subject to the understanding that Buyer and Seller agree that a reserve of $450,000.00 is adequate for all obsolete and unusable inventory that may be on hand as of the Closing Date. All finished goods comply with normal commercial standards in the rail and air line industries, as the case may be, and with all applicable laws,

rules and regulations pertaining to the Company's anticipated use of such finished goods.

2.17 *Pension and Profit Sharing Plans.*

(a) *Hourly Employees Pension Plan.* The Company has heretofore established the AMI Industries Inc. Hourly Employees' Retirement Plan (the "Hourly Plan") for its hourly employees. Pursuant to the Hourly Plan, the Company has established a trust (the "Hourly Trust") with individual trustees, which trustees are the "contract holder" of a group annuity contract issued by Aetna Life Insurance Company, and the Company has transferred funds to the Hourly Trust for the purpose of funding benefits under the Hourly Plan. True and correct copies of the Hourly Plan and Hourly Trust as of the date hereof are attached hereto as SCHEDULE 2.17(a). Prior to the Closing Date, the Company shall have accrued contributions to the Hourly Trust through the Closing Date in accordance with the amounts described in the actuarial valuation report prepared by the Plan's actuaries, Reed-Ramsey, Inc., for the 1982 Plan Year.

* * *

2.18 *Labor Problems.* Since December 31, 1976, the Company has never suffered a material work stoppage, and no work stoppage is presently threatened. Attached hereto as SCHEDULE 2.18(a) is a list of outstanding written labor grievances as of the date hereof and, as of the date hereof, there are no other material written labor grievances involving any labor unions representing any of the employees of the Company. Attached hereto as SCHEDULE 2.18(b) is a list of all labor organizations or associations of employees with which the Company has any written or oral contract with or commitments or liabilities to, along with a copy of any written contract and a statement describing any oral contract or commitment.

2.19 *Customers and Suppliers.* Attached hereto as SCHEDULE 2.19 is a list of (a) the ten largest customers of the Company (in dollar volume for the fiscal year ended December 31, 1981 and for the current fiscal year through October 31, 1982); and (b) the ten largest suppliers of the Company (in dollar volume for the fiscal year ended December 31, 1981 and for the current fiscal year through October 31, 1982); and (c) any current sole-source supplier of significant goods or services to the business of the Company (other than electricity, gas, telephone or water) with respect to which their unavailability would at the Closing Date, have a material adverse effect upon the Company's business. Neither Seller nor the Company has any information or knowledge which indicate that any of the customers or suppliers listed in Schedule 2.19 will cease to do business with the Company or will reduce the volume of their business with the Company in a way which would have a material adverse effect upon the Company's business.

2.20 *Subsidiary Corporations.* Except as set forth on SCHEDULE 2.20, the Company does not own, directly or indirectly, any interest in any corporation, business trust, joint stock company, or other business organization or association. The Company is not a general partner of any partnership or a party to any joint venture.

2.21 *Dividends.* The Company has not since June 30, 1982 declared or paid or made any payment of a dividend or other distribution to its shareholders or purchased, redeemed, or otherwise acquired or disposed of any share of its stock; and the Company has not, except in the ordinary course of business or except as specifically permitted by this Agreement, paid or discharged any outstanding indebtedness.

2.22 *Closing Statements.* Seller shall deliver to the Buyer on or before the Closing a true and complete list, as of the date hereof and certified by the Company's chief financial officer, showing: (a) the names of all persons whose compensation for the Company for the fiscal year ending December 31, 1982 will equal or exceed $35,000.00; (b) the name of each bank in

which the Company has an account or safe deposit box and the names and identification of all persons authorized to draw thereon or to have access thereto; and (c) the name of all persons, if any, holding tax or other powers of attorney from the Company and a summary statement of the terms thereof.

2.23 *Conduct of Company's Business Prior to Closing.* Between October 31, 1982 and the Closing Date, except with the prior written consent of Buyer, Seller shall have caused the Company: (a) To conduct its business only in the ordinary and usual course; (b) To not change the character of its business or undertake any new business; (c) To not enter into any employment contracts; (d) To not sell any of its assets except in the ordinary course of business and for good and sufficient consideration; (e) To not amend, terminate or change any material contracts listed in SCHEDULE 2.11; (f) To not sell or issue any stock, bonds or other securities or rights therein; (g) To not incur any obligation or liability except in the ordinary course of business; (h) To not make any payment to Seller, except to pay interest or principal on the intercorporate debt referred to at Section 1.03(a)(i), above or to pay the regular, periodic management fee as paid or accrued to the Closing Date; (i) To not mortgage, pledge or subject to lien or encumbrance any of its assets, tangible or intangible; (j) To not make any contribution or incur any indebtedness under the Hourly Plan, the Salaried Plan or the Thrift Plan except to the extent provided herein, and to not make any amendments to or changes in the Hourly Plan, Hourly Trust, Thrift Plan or Thrift Trust.

2.24 *Warranty of Product.* The Company has provided purchasers of its finished goods with various product warranties. Such warranties are individually negotiated, and the Company does not have any one form of warranty that has been provided with respect to more than ten percent of its sales in any calendar year, other than as described in SCHEDULE 2.24. The Company's financial statements present fully and fairly the Company's expenses and obligations related to

product warranties in conformity with generally accepted accounting principles applied on a consistent basis.

* * *

ARTICLE III

WARRANTIES OF BUYER

* * *

ARTICLE IV

CLOSING

4.01 *Time and Place of Closing.* This transaction shall close ("the Closing") at such location in Los Angeles County, California as Buyer shall designate, or, if Buyer consents, at such other location as Buyer and Seller shall mutually agree. The Closing shall take place on December 15, 1982 at 10:00 A.M. (the "Closing Date").

4.02 *Documents Delivered by Seller to Buyer at the Closing.* At the Closing, Seller shall deliver the following documents to Buyer:

(a) A stock certificate or certificates representing all of the Shares, duly endorsed for transfer to Buyer;

(b) The statement of Ernst & Whinney as required by Section 1.03(a)(i), above;

(c) Seller's written release of the Company from any debts or claims, including specifically the intercorporate debt, but excluding the Company's obligations with respect to corporate income taxes as provided in Section 2.07 above, whether accrued, absolute, contingent or otherwise, and whether due or to become due, known or unknown, in form and substance satisfactory to Buyer and its counsel;

(d) A certificate from the Secretary of State of the State of Colorado dated no earlier than November 30, 1982 that the Company is in good standing in such state;

(e) An opinion of Daniel P. Edwards, Esq. in form and substance satisfactory to buyer and its counsel to the effect that the warranties and representations contained in Sections 2.01, 2.02, 2.04, 2.05, 2.06, 2.08, 2.09, 2.11, 2.18, the last sentence of 2.19, 2.20 and 2.25 of this Agreement are true and correct to the best of said counsel's knowledge and further to the effect that: (a) the Company has been duly incorporated and is validly existing, in good standing, under the laws of the state of Colorado, has all requisite corporate power and authority to own its properties and carry on its business as conducted on the date of the Closing, and as of such date has all licenses, permits, or other authorizations, and has taken all actions required by applicable law or governmental regulations in connection with its business as then conducted; (b) the Company has authorized and outstanding capital stock as set forth in Paragraph 2.08 and all shares of its outstanding capital stock have been duly and validly authorized and issued and are fully paid and nonassessable; (c) except as may be set forth in SCHEDULE 2.09 hereof, such counsel does not know (after reasonable investigation) of any litigation, proceedings, or governmental investigation or labor dispute pending or threatened against or relating to the Company; (d) such counsel does not know or have reason to know (after reasonable investigation) that there are any defects in or encumbrances upon the title of the Company to its property and assets and leaseholds which would violate the representations in Article II of this Agreement; and (e) as to such other legal matters as Buyer may reasonably require.

(f) An opinion of Messrs. Mayer, Brown & Platt in form and substance satisfactory to Buyer and its counsel to the effect that the warranties and representations contained in Sections 2.02, 2.09, 2.14, and 2.17 of this Agreement as they pertain to Seller are true and correct to the best of said counsel's knowledge, and further to the effect that: (a) Seller has complete and unrestricted power under its Articles of Incorporation and By-Laws to sell, convey, assign, transfer, and deliver to Buyer the Shares to be sold by Seller under this agreement; (b) this Agreement is the valid and binding obligation of Seller and is enforceable against Seller in accordance with its terms and conditions, and will not conflict with, or result (immediately or upon the giving of notice and/or upon the passage of a period of time) in a breach of, any of the terms of any indenture, mortgage, deed of trust, or other agreement, instrument or understanding to which Seller is a party or by which it is or may be bound, or constitute a default thereunder, or result in the creation or imposition of any lien, charge, or encumbrance, or give to others any interest or right in the Shares or in any of the properties or other assets of the Company; and (c) as to such other legal matters as Buyer may reasonably require; and

(g) Such other documents as may otherwise be required by this Agreement.

4.03 *Documents to be Delivered by Buyer to Seller.* Buyer shall deliver or cause delivery of the following to Seller at the Closing:

(a) The cash required by Section 1.03(a), above;

(b) The Notes required by Section 1.03(b), above;

(c) The Security and Pledge Agreement required by Section 1.05, above;

(d) Assignments of Buyer's interest in and to the oil and gas revenues of Buyer's wholly-owned subsidiary,

Algeran-Savage corporation, subordinate to the rights of Union Bank, as security under the Security and Pledge Agreement;

(e) A stock certificate or certificates representing all of the Shares, with stock powers executed in blank, as security under the Security and Pledge Agreement; and

(f) An opinion of STERN & MILLER, a Professional Corporation, in form and substance satisfactory to Seller and its counsel to the effect that the warranties and representations contained in Sections 3.01 and 3.02 of this Agreement are true and correct to the best of said counsel's knowledge, and further to the effect that: (a) such counsel does not know (after reasonable investigation) of any litigation or proceeding pending or threatened against Buyer, except as set forth on SCHEDULE 3.04; (b) this Agreement is the valid and binding obligation of Buyer and is enforceable against Buyer in accordance with its terms and conditions, and will not conflict with, or result (immediately or upon the giving of notice and/or upon the passage of a period of time) in a breach of, any of the terms of any indenture, mortgage, deed of trust, or other agreement, instrument or understanding to which Buyer is a party or by which it is or may be bound, or constitute a default thereunder; and (c) as to such other legal matters as Seller may reasonably require.

ARTICLE V

ADDITIONAL COVENANTS OF SELLER

5.01 *Books and Records—Cooperation and Assistance*

(a) *Preparation of Audited Financial Statements.* Seller's independent auditors, Ernst & Whinney (the "Auditors"), have examined and issued their opinion on Advance Ross Corporation's consolidated financial statements for each of the three

years in the period ended December 31, 1981 which include the financial statements of the Company. Within forty-five days after the Closing Date, Seller shall deliver to Buyer audited balance sheets of the Company as of December 31, 1980 and December 31, 1981 and statements of operation and changes in financial position for each of the three years in the period ended December 31, 1981 prepared in accordance with generally accepted accounting principles applied on a consistent basis except for the change, in 1980, in the method of determining inventory costs as described in Note B to the consolidated financial statements of Advance Ross Corporation for the year ended December 31, 1981. Such audit will be performed by Ernst & Whinney, whose fees and costs for such professional services shall be paid by Buyer or the Company, as Buyer shall choose.

(b) *Preservation of and Access to Books and Records.* Except to the extent that Seller shall transfer any of such books and records to Buyer as hereinafter provided, Seller shall, for a period of at least ten (10) years after the Closing Date, preserve or cause to be preserved all books and records in its possession or control (including, without limitation, books and records in the possession or control of Seller's attorneys and accountants) pertaining to the Company, and Seller shall make them available to Buyer or its authorized representatives at all reasonable times during said period for inspection and making copies and extracts therefrom for any proper purpose; and Seller shall permit Buyer to remove such books and records in connection with any proceedings, claims or actions which may be brought against Buyer or the Company in any judicial or formal or informal administrative proceeding or before any arbitration tribunal in connection with the Company.

* * *

5.03 *Indemnification.* If and to the extent that Buyer is damaged in an amount in excess of $25,000.00 in the aggregate,

net of reimbursement by insurance or other third parties, by reason of a breach or breaches of any warranty, representation or covenant of Seller, including the existence of any tax deficiency, or any losses with respect to any claims described in SCHEDULE 2.09, Seller shall forthwith pay or credit to Buyer the amount of damages caused by said breach or breaches of warranty to the extent that the aggregate of such damages exceed said $25,000.00. Seller shall indemnify, defend and hold Buyer and the Company harmless from and against any assessment, claim, lien or liability for taxes asserted against Buyer or the Company for any period prior to the Closing Date or for taxes of the Seller's consolidated group for any period prior to December 31, 1982. As a condition precedent to the right to enforce its right of indemnification, buyer is hereby required to give written notice of any claim of breach of warranty, representation or covenant to Seller within ninety (90) days after discovery of such breach. Additionally, Seller shall not have any liability to buyer for breach of warranty: (a) For any matter other than tax deficiencies unless a written claim is filed with Seller on or before December 31, 1984; and (b) For tax deficiencies unless a written claim is filed with Seller within 90 days of the expiration of the applicable statute of limitations. Notwithstanding the foregoing, the total amount to be paid or credited to Buyer hereunder shall not exceed $800,000.00 in the aggregate.

5.04 *Accuracy of Representations and Warranties.* The representations and warranties set forth in ARTICLE II hereof shall be true and correct in all respects at and as of the Closing Date.

* * *

5.07 *Change of Board of Directors.* At the Closing, Seller shall take such steps as are reasonably necessary to cause all members of the Board of Directors of the Company to be comprised of persons designated in writing by Buyer.

* * *

ARTICLE VI

Additional Covenants of Buyer

Buyer hereby agrees:

6.01 *Indemnity from Claims of Brokers.* Buyer warrants and represents that it has not engaged any broker or finder in connection with this transaction other than Robert Berner, and that no person other than said Robert Berner has made any claim against it for any finder's fee. Buyer is solely responsible for any broker's or finder's fee payable to said Robert Berner, and Buyer agrees to indemnify and hold Seller harmless against or in respect of any commissions or brokerage fees incurred or alleged to be incurred pursuant to any alleged arrangements with Buyer.

* * *

6.06 *Accuracy of Representations and Warranties.* The representations and warranties set forth in ARTICLE II hereof shall be true and correct in all respects at and as of the Closing Date.

6.08 *Absence of Material Changes.* Between the date of the July 31, 1982 financial statements and the Closing Date, there shall have been no material adverse change in the financial position of the Buyer.

ARTICLE VII

Products Liability

7.01 *Seller's Indemnification.* Seller agrees to indemnify, defend and hold Buyer and the Company harmless from and against any products liability or similar claim or action relating to finished goods of the Company which were manufactured

prior to the Closing Date, including all costs, expenses and attorneys' fees in connection with the defense of any such action or claim.

7.02 *Buyer's Indemnification.* Buyer agrees to indemnify, defend and hold Seller harmless from and against any products liability or similar claim or action relating to finished goods of the Company which are manufactured after the Closing Date, including all costs, expenses and attorneys' fees in connection with the defense of any such action or claim.

* * *

ARTICLE VIII

MISCELLANEOUS MATTERS

8.01 *Notices.* Any notice, request, instruction, or other document deemed by either party to be necessary or desirable to be given to the other party shall be in writing and shall be mailed by registered or certified mail, postage prepaid, with return receipt requested, addressed as follows:

TO SELLER:	Mr. Harve A. Ferrill, President ADVANCE ROSS CORPORATION 111 West Monroe Street Chicago, Illinois 60603
with a copy to:	Harvey Nixon, Esq. MAYER, BROWN & PLATT 231 South LaSalle Street Chicago, Illinois 60604

TO BUYER:	Mr. Robert W. Miller, Chairman ALGERAN, INC. 890 South Arroyo Parkway Pasadena, California 91105
with a copy to:	Michael D. Miller, Esq. STERN & MILLER, a Professional Corporation 606 Wilshire Boulevard, Suite 706 Santa Monica, California 90401
TO COMPANY:	Mr. Tom Carlsen Chief Financial Officer AMI INDUSTRIES, INC. 3200 North Nevada Colorado Springs, Colorado 80907

8.02 *Entire Agreement.* This Agreement contains the entire agreement between the parties hereto and supersedes any and all prior agreements, arrangements, or understandings between the parties relating to this Agreement. No oral understandings, statements, promises or inducements contrary to the terms of this Agreement exist. No representations, warranties, covenants or conditions, express or implied, whether by statute or otherwise other than as set forth herein, have been made by any party hereto. No waiver of any term, provision or condition of this Agreement, whether by conduct or otherwise, in any one or more instances shall be deemed to be or construed as a further or continuing waiver of any such term, provision, or condition or any other term, provision or condition of this Agreement. This Agreement cannot be changed or terminated orally.

8.03 *Applicable Law.* This Agreement shall be governed by, and construed and enforced in accordance with, and subject to, the laws of the State of California.

8.04 *Arbitration of Disputes.* In the event any controversy or claim as to matters arising out of this Agreement cannot be settled by the parties or their legal representatives, such con-

troversy or claim shall be settled by arbitration in accordance with the then current rules of the American Arbitration Association and judgment upon the award may be entered in any court having jurisdiction thereof.

8.05 *Binding on Successors.* All of the terms, provisions and conditions of this Agreement shall be binding upon and inure to the benefit of the parties hereto and their successors in interest of every kind and nature whatsoever.

8.06 *Survival of Representations.* All representations, warranties, agreements and covenants made by the parties hereto in this Agreement or pursuant hereto shall be deemed to have been made for the purpose of inducing the other party to enter into this Agreement, and shall survive the Closing and remain operative thereafter to and through December 31, 1984 but all representations, warranties, agreements and covenants of Seller contained in Section 2.07 concerning taxes shall remain operative until the applicable statute of limitations concerning the assessment and collection of taxes has expired.

8.07 *Titles.* The titles of the articles and sections of this Agreement are for convenience of reference only and are not to be considered in construing this Agreement.

8.08 *Counterparts.* This Agreement may be executed in one or more counterparts, each of which shall be deemed an original and all of which taken together shall constitute one and the same document.

8.09 *Exhibits and Schedules.* To the extent that any exhibits or schedules have not previously been delivered to Buyer or Seller, Buyer and Seller agree to deliver such exhibits and schedules at the Closing. With respect to any exhibits or schedules delivered by either Buyer or Seller prior to the Closing, Buyer or Seller, as the case may be, shall provide the other with a certificate which represents, warrants and covenants that there have been no changes in or to such exhibits or schedules except as disclosed in the certificate.

IN WITNESS WHEREOF, the parties hereto set their hands on the day and year first above written.

SELLER: ADVANCE ROSS CORPORATION

By /s/ Harve A. Ferrill
Harve A. Ferrill
President

AD ROSS CORPORATION

By /s/ Harve A. Ferrill
Executive Vice President

BUYER: ALGERAN, INC.

By /s/ Robert R. Susnar
Robert R. Susnar,
President

[Schedules and Exhibits Omitted]